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ESG Performance and Firm Value: The Mediating Role of Corporate Profitability among IDX ESG Leaders

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Abstract

Purpose: This study examines the effects of Environmental, Social, and Governance (ESG) performance on firm value, with profitability as a mediating variable, among companies included in the IDX ESG Leaders Index during 2021–2024.

Research Methodology: his quantitative study uses firm-year observations from 18 companies that were consistently included in the IDX ESG Leaders Index throughout the 2021–2024 period, resulting in 72 firm-year observations. The companies were selected using purposive sampling. Secondary data obtained from annual and sustainability reports were analyzed using Partial Least Squares Structural Equation Modeling.

Results: Environmental and Governance Performance significantly enhance profitability and firm value, while Social Performance has no significant effect. Profitability positively affects firm value and significantly mediates the effects of Environmental and Governance Performance, but not Social Performance, on firm value.

Conclusions: Environmental and Governance Performance contribute to firm value directly and through improved profitability, whereas Social Performance does not show a significant relationship with profitability or firm value.

Limitations: This study is limited to 18 companies consistently included in the IDX ESG Leaders Index during the 2021–2024 period, which may constrain generalizability and the ability to capture long-term ESG impacts.

Contributions: This study contributes to the ESG literature by proposing an integrated theoretical framework that extends Stakeholder Theory and Signaling Theory, offering a new theoretical perspective on how distinct ESG dimensions influence profitability and firm value among companies listed in the IDX ESG Leaders Index.

Keywords: *ESG Performance, Firm Value, IDX ESG Leaders, Profitability, Sustainability*

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1. Introduction

The growing number of companies included in the IDX ESG Leaders Index reflects the increasing relevance of Environmental, Social, and Governance (ESG) considerations in the Indonesian capital market. The index comprises companies that demonstrate relatively strong ESG performance and are

expected to have greater capacity to manage sustainability-related risks and stakeholder expectations (Lita & Faisol, 2025). Companies included in this index are considered to possess superior governance, thereby boosting investor confidence and market valuation (Rusmana & Sembiring, 2025). ESG performance is increasingly associated with corporate value creation because effective environmental, social, and governance practices can strengthen stakeholder relationships, corporate reputation, risk management, and long-term business prospects (Buniarto, Ferriswara, Saptaria, & Masudin, 2026; Choithramani, Pandey, & Debata, 2026; Darsono, Riska, & Nahar, 2024; Laokulrach, 2025). ESG integration has become a vital strategy for maintaining market appeal and ensuring business continuity (Rohisham, Muda, & Borhan, 2025). Nevertheless, whether ESG performance is consistently reflected in firm value remains an empirical question, particularly because the economic benefits of ESG may operate through different financial mechanisms (Rahmah, Purwohedi, & Handarini, 2024).

Empirical evidence regarding the relationship between ESG and firm value remains mixed, particularly when ESG is examined by individual dimensions (Zheng, Wang, Sun, & Li, 2022), whereas Environmental Performance does not show a significant effect (Setioko, 2024). Concurrently, all three ESG dimensions positively influence profitability (Aydoğmuş, Gülay, & Ergun, 2022). Corporate value is reflected in market perceptions of earnings performance (Yeye & Egbunike, 2023). These findings suggest that ESG should not necessarily be treated as a homogeneous construct because its individual dimensions may generate different economic consequences. From a Stakeholder Theory perspective, ESG practices enable firms to respond to the expectations of employees, customers, suppliers, regulators, communities, and other stakeholders, potentially generating reputational benefits, customer loyalty, access to resources, and lower social or environmental risks (Phillips, Barney, Freeman, & Harrison, 2019). Strong ESG performance demonstrates a company's ability to meet the expectations of these various groups. By effectively maintaining stakeholder relationships, a company can derive economic benefits such as an enhanced reputation, customer loyalty, regulatory support, access to resources, and a reduction in the risk of social or environmental conflict (Kong, Akbar, & Poulova, 2023). Ultimately, these benefits can strengthen the sustainability of cash flows and the company's future prospects. Previous research also indicates that ESG can generate value through positive stakeholder responses including reputation, access to capital, and risk mitigation (Alsayegh, Abdul Rahman, & Homayoun, 2023; Zheng et al., 2022). These benefits may subsequently contribute to financial performance and long-term firm value.

Signaling Theory provides a complementary explanation of how ESG performance may be translated into market value. Because investors face information asymmetry concerning firms' internal conditions and future prospects, ESG performance and its disclosure can function as signals of management quality, transparency, risk management, and sustainability orientation (Connelly, Certo, Reutzel, DesJardine, & Zhou, 2025; Wang, Adouko, & Teye, 2026). While Stakeholder Theory explains the internal and relational aspects of value creation, Signaling Theory explains how the market interprets ESG benefits and information into corporate valuation. In this context, profitability acts as a variable explaining how specific factors influence firm value (Wangi & Aziz, 2023). While Stakeholder Theory emphasizes the value created through relationships with stakeholders, Signaling Theory explains how ESG-related information can influence investors' perceptions and market valuation. Consequently, the relationship between ESG and firm value may involve both an internal economic mechanism and an external market-perception mechanism. Profitability is particularly relevant in this process because improved profitability provides observable financial evidence that ESG-related practices have generated economic benefits, which may subsequently influence investor assessments of firm value (Alsayegh et al., 2023).

The role of profitability as a mechanism linking ESG performance and firm value, however, remains inconclusive. Some studies report a positive relationship between ESG performance and firm value (Necib, Gmati, & Jarboui, 2024; Yeye & Egbunike, 2023). Whereas others find no significant relationship (Putra & Budastra, 2024; Sari, Hadi, & Sudirwo, 2025). Evidence concerning profitability as a mediator is similarly mixed. Wangi and Aziz (2023) demonstrate that profitability is an important determinant of firm value, while their findings indicate that ESG does not necessarily have a direct

effect on firm value. In contrast, Rusmana and Sembiring (2025) report that ESG performance positively affects firm value and that profitability mediates this relationship. These findings establish profitability as a potentially important transmission mechanism, but they do not fully resolve whether the mechanism operates similarly across the Environmental, Social, and Governance dimensions.

This unresolved issue constitutes an important research gap. Although Rusmana and Sembiring (2025) provide evidence of the mediating role of profitability in the ESG–firm value relationship, the present study differs in its analytical emphasis by examining the Environmental, Social, and Governance dimensions separately rather than treating ESG only as an aggregate construct. This distinction is important because prior evidence indicates that individual ESG dimensions may have different effects on firm value and profitability (Aydoğmuş et al., 2022). Stakeholder Theory posits that the effective implementation of ESG practices can bolster legitimacy, reputation, and stakeholder trust, thereby supporting corporate sustainability and long-term value creation (Prayogo, Sudarma, Purwanti, & Adib, 2026). Meanwhile, Signaling Theory explains that the disclosure of ESG performance serves as a positive signal regarding governance quality, commitment to sustainability, and the company's future prospects. Such information can reduce information asymmetry between management and investors, enhance market confidence, and drive an increase in firm value (Surya, Andreas, Halim, & Zarefar, 2026). In this study, profitability is positioned as the mechanism explaining how ESG implementation translates into superior financial performance, which the market subsequently rewards with increased firm value (Indriani, 2024). Accordingly, the present study investigates whether profitability functions as a transmission mechanism for each ESG dimension and whether Environmental, Social, and Governance performance generate firm value through comparable or distinct financial pathways. The study further focuses specifically on companies included in the IDX ESG Leaders Index during 2021–2024, thereby providing evidence from firms that are explicitly recognized within the Indonesian capital market for their ESG performance. By integrating Stakeholder Theory and Signaling Theory, the study seeks to explain both the stakeholder-based economic benefits of ESG and the market-based interpretation of those benefits.

This study examines the effects of the Environmental, Social, and Governance (ESG) dimensions on firm value, with profitability as a mediating variable, among companies listed on the IDX ESG Leaders Index from 2021–2024. The study contributes theoretically by clarifying how profitability mediates the ESG firm value relationship and how individual ESG dimensions affect firm value. Practically, the findings provide insights for managers, investors, and regulators in developing effective ESG strategies, informed investment decisions, and sustainable capital market policies.

2. Literature Review and Hypotheses Development

2.1 Stakeholder Theory

Stakeholder Theory views the firm as an organization that creates value through relationships with multiple stakeholders, including employees, customers, suppliers, government, communities, and the environment (Mahajan, Lim, Sareen, Kumar, & Panwar, 2023; Freeman, 2015). These stakeholders provide resources and support that influence the firm's ability to maintain its operations and achieve long-term performance (Phillips, Barney, Freeman, & Harrison, 2019). Therefore, firms that respond effectively to stakeholder interests can strengthen stakeholder relationships and secure resources that support organizational performance (Zheng, Wang, Sun, & Li, 2022).

Within the ESG context, Stakeholder Theory provides the primary explanation for why environmental, social, and governance practices may influence corporate performance (Zhang, 2024). Environmental initiatives can improve resource efficiency and stakeholder trust, social practices can strengthen relationships with employees and other stakeholder groups, while governance mechanisms can enhance accountability and stakeholder confidence. These outcomes may contribute to profitability by improving operational efficiency, reducing stakeholder-related risks, and strengthening access to critical resources. ESG performance may also influence firm value when stakeholder-oriented practices enhance the firm's long-term economic prospects and legitimacy (Kriswanti & Indriani, 2025).

2.2 Signaling Theory

Signaling Theory explains how firms communicate information to external parties, particularly investors, in situations characterized by information asymmetry (Pulino et al., 2022). Corporate disclosures and observable performance provide signals that investors can use to assess the firm's quality, prospects, and risk. Connelly et al. (2025) further emphasize that signals are strategically relevant when external stakeholders cannot directly observe all aspects of a firm's underlying quality (Connelly et al., 2025).

In this study, ESG performance functions as a non-financial signal of the firm's commitment to responsible management, sustainability, and effective governance. Because ESG practices require organizational resources and are externally observable through corporate disclosures, stronger ESG performance may reduce information asymmetry and strengthen investor perceptions of the firm's long-term prospects (Rahayu & Sanjaya, 2024). Consequently, ESG performance may contribute to firm value by providing information that investors incorporate into their assessments of the company.

Signaling Theory also explains the role of profitability in the ESG–firm value relationship. Profitability represents an observable financial outcome that signals the firm's ability to convert its resources and strategies into economic returns (Nadifah, Dahlan, & Handoyo, 2025). Accordingly, the theory supports the mediating mechanism in which ESG performance is associated with profitability, while profitability subsequently provides a financial signal that is reflected in firm value.

2.3 The Relationship Between ESG Performance and Profitability

According to Stakeholder Theory, firms create value by balancing the interests of stakeholders who influence or are affected by their activities (Freeman, 1999). Environmental Performance reflects a firm's efforts to manage environmental impacts through emission reduction, energy efficiency, waste management, and sustainable resource use. Such practices can improve operational efficiency, reduce environmental risks, and strengthen corporate reputation (Rayis, Juanda, & Wicaksono, 2025). Empirical evidence also indicates that ESG performance can enhance profitability (Aydoğmuş et al., 2022). Therefore, stronger Environmental Performance is expected to improve profitability.

H_1: Environmental Performance has a positive effect on profitability

Social Performance concerns a firm's efforts to address the interests and welfare of employees, customers, suppliers, communities, and other social stakeholders, including labor rights, employee development, diversity, consumer protection, and community engagement (Schaltegger, Hörisch, & Freeman, 2019). Effective social practices can strengthen stakeholder relationships, enhance employee commitment and customer trust, and reduce social risks (Phan, 2024). Empirical evidence indicates that the Social dimension of ESG can positively contribute to profitability (Aydoğmuş et al., 2022). Therefore, stronger Social Performance is expected to improve profitability.

H_2: Social performance has a positive effect on profitability

Governance Performance reflects the quality of corporate oversight, accountability, transparency, independence, and stakeholder protection. Effective governance can reduce agency conflicts, information asymmetry, and corporate risks while improving decision-making and resource allocation. From the Stakeholder Theory perspective, transparent and accountable governance strengthens stakeholder confidence, while Signaling Theory suggests that governance quality signals managerial reliability to external stakeholders. Empirical evidence shows that Governance Performance is positively associated with profitability, as effective governance can improve decision-making efficiency, reduce agency costs, and mitigate corporate risks (Aydoğmuş et al., 2022). Therefore, stronger Governance Performance is expected to improve profitability.

H_3: Governance performance has a positive effect on profitability

2.4 The Relationship Between ESG Performance and Firm Value

Environmental Performance can influence firm value through improved resource efficiency, reduced environmental risks, stronger corporate reputation, and greater preparedness for environmental regulations. These benefits can contribute to long-term cash-flow stability and reduce uncertainty regarding future operating performance. However, environmental initiatives may require substantial initial investment, while their financial benefits may materialize over a longer period (Saksonova & Buša, 2025). Consequently, the market may not immediately incorporate all environmental benefits into firm valuation. Nevertheless, empirical evidence indicates that ESG performance can contribute to firm value, although the magnitude and significance of the effect may vary across dimensions and contexts (Aydoğmuş et al., 2022; Zheng et al., 2022). Thus, the hypotheses proposed in this study are as follows:

H_4: Environmental performance has a positive effect on firm value

Social Performance represents a firm's commitment to employees, customers, suppliers, communities, and other social stakeholders. Socially responsible practices can improve employee well-being and productivity, strengthen customer loyalty, enhance corporate reputation, and reduce the likelihood of labor or community-related conflicts (Permana, Buniarto, & Saptaria, 2025). These outcomes can support more stable operations and future cash flows, which are relevant to market-based firm valuation. Empirical evidence supports the potential value relevance of Social Performance. Zheng et al. (2022) found that Social Performance positively influences firm value, while Aydoğmuş et al. (2022) reported that the Social dimension contributes positively to profitability. These findings suggest that social practices may affect firm value both directly through stakeholder perceptions and indirectly through improved financial performance. Although the economic benefits of social initiatives may be more difficult to measure and may materialize over a longer period, their effects on reputation, employee productivity, customer relationships, and stakeholder trust can provide economically relevant signals to investors. Therefore, despite variations in findings across studies and contexts, this study expects stronger Social Performance to be associated with higher firm value.

H_5: Social performance has a positive effect on firm value

Governance Performance concerns transparency, accountability, managerial oversight, board independence, and the protection of shareholder and stakeholder rights. Strong governance can reduce agency conflicts, improve information quality, strengthen risk control, and increase investor confidence. Because these mechanisms are closely related to information asymmetry and investor protection, governance information can be particularly relevant to market valuation. Empirical research provides support for a positive association between Governance Performance and firm value. Zheng et al. (2022) found that Governance Performance positively affects firm value, while Aydoğmuş et al. (2022) reported a positive relationship between Governance Performance and profitability. These findings indicate that governance can create economic value by improving managerial efficiency, reducing risks, and strengthening investor confidence. Accordingly, stronger Governance Performance is expected to enhance firm value.

H_6: Governance performance has a positive effect on firm value

2.5 The Relationship Between Profitability and Firm Value

Profitability reflects a company's ability to manage resources to generate profit. Higher profitability indicates a greater capacity to create earnings from existing assets and capital (Ariutami, Novitasari, & Dewi, 2026; Noviani, Sa'diyah, Rohmah, Shohib, & Hanifah, 2026). In the capital market, profitability represents an important indicator through which investors assess managerial effectiveness, financial strength, and future growth prospects. Empirical evidence generally supports the relevance of profitability to firm value. Pulino et al. (2022) indicate that effective resource utilization and financial performance strengthen organizational sustainability and stakeholder confidence. Higher profitability may also provide a positive signal to investors regarding management quality and the firm's ability to generate sustainable future cash flows. From the perspective of

Signaling Theory, stronger profitability reduces uncertainty concerning future economic performance and can therefore improve market valuation. Accordingly, firms with higher profitability are expected to have higher firm value (Pulino et al., 2022). Thus, the following hypothesis is proposed:

H_7: Profitability has a positive effect on firm value

2.6 The Mediating Role of Profitability

Environmental Performance can improve profitability through more efficient resource utilization, lower energy and waste-related costs, reduced environmental risks, and enhanced corporate reputation. Aydoğmuş et al. (2022) found that Environmental Performance is positively associated with profitability, while evidence from the firm-value literature indicates that ESG performance can contribute to corporate valuation (Necib, Gmati, & Jarboui, 2024; Yeye & Egbunike, 2023). Therefore, environmental practices may affect firm value through the financial benefits generated by improved operational efficiency and risk management. Profitability can make these benefits more visible to investors because stronger earnings provide observable evidence of the economic consequences of environmental initiatives. Accordingly, profitability is expected to mediate the relationship between Environmental Performance and firm value.

H_8: Profitability mediates the effect of environmental performance on firm value

Social Performance can generate economic benefits through stronger employee commitment, higher productivity, customer loyalty, improved corporate reputation, and more stable relationships with communities and other stakeholders. Aydoğmuş et al. (2022) found that Social Performance positively influences profitability, while Zheng et al. (2022) found a positive relationship between Social Performance and firm value. Together, these findings provide empirical support for the possibility that social initiatives create value through both financial performance and market perceptions. The financial effects of social initiatives may, however, emerge gradually because improvements in employee commitment, customer relationships, and corporate reputation are not always immediately reflected in accounting performance or market valuation. Profitability can therefore serve as a mechanism that converts these stakeholder-related benefits into observable financial outcomes. Once reflected in stronger profitability, the economic benefits of Social Performance can provide a clearer signal to investors and potentially contribute to higher firm value. Thus, profitability is expected to mediate the relationship between Social Performance and firm value.

H_9: Profitability mediates the effect of social performance on firm value

Governance Performance can influence profitability by improving managerial oversight, resource allocation, transparency, risk management, and accountability. Aydoğmuş et al. (2022) found that Governance Performance positively affects profitability, while Zheng et al. (2022) reported a positive relationship between Governance Performance and firm value. These findings indicate that governance may generate value through both improved financial performance and stronger investor confidence. The better a company manages environmental, social, and governance aspects, the greater its chances of reaping benefits from stakeholder relationships, which in turn boosts profitability (Duan, Yang, & Xiong, 2023). Therefore, the following hypotheses are proposed:

H_{10}: Profitability mediates the effect of governance performance on firm value

3. Research Methodology

The final sample consisted of 72 firm-year observations from 18 companies that were consistently included in the IDX ESG Leaders Index during 2021–2024 (Jao, Asri, & Mardiana, 2026). The sample was selected using purposive sampling based on continuous index inclusion and the availability of complete annual and sustainability reports. Sample adequacy was assessed based on the maximum number of structural predictors in the model, while recognizing that the 72 observations represent repeated observations from 18 companies rather than 72 independent firms. Each company was assigned a unique company identifier (*company ID*) to preserve the longitudinal structure of the data.

The three ESG dimensions Environmental Performance, Social Performance, and Governance Performance were specified as formative constructs and measured using indicators derived from the Global Reporting Initiative (GRI) Standards. The GRI Standards provide a comprehensive framework for reporting an organization's economic, environmental, social, and governance impacts (Glavič, 2026). They comprise Universal Standards, Sector Standards, and Topic Standards, which facilitate the identification of relevant information concerning corporate sustainability performance (Farida, Iqbal, & Fitriani, 2026).

Environmental Performance was operationalized using 10 indicators reflecting the company's environmental impacts and environmental management practices. Social Performance was measured using 10 indicators representing the company's relationships, responsibilities, and impacts toward employees, communities, customers, and other social stakeholders. Governance Performance was measured using 10 indicators representing governance structure, responsibilities, transparency, accountability, and corporate governance practices. Relevant information for each indicator was identified through a systematic review of the annual and sustainability reports of the sampled companies. In particular, GRI 2 provides disclosures related to governance structure and composition, the roles and responsibilities of governance bodies, collective knowledge, performance evaluation, and remuneration, while GRI 3 provides guidance for identifying and managing material topics (Choy, 2026).

The three ESG dimensions were specified as formative rather than reflective because the individual disclosure indicators represent distinct and non-interchangeable aspects of ESG performance that collectively form each dimension. The presence or absence of one disclosure item does not necessarily imply the presence or absence of other items. Therefore, the indicators are considered components that contribute to the formation of the respective ESG construct rather than manifestations of an underlying latent variable. Each indicator was coded using a binary scoring procedure. A value of 1 was assigned when the company disclosed information corresponding to the specified indicator, whereas a value of 0 was assigned when the relevant information was not disclosed. ESG performance is measured using the following Formula 1, 2, 3:

$$EP_{it} = \frac{\sum_{j=1}^{10} E_{ijt}}{10} \quad (1)$$

$$SP_{it} = \frac{\sum_{j=1}^{10} S_{ijt}}{10} \quad (2)$$

$$GP_{it} = \frac{\sum_{j=1}^{10} G_{ijt}}{10} \quad (3)$$

Notes:
EP = Environmental Performance
SP = Social Performance
GP = Governance Performance
E,S,G = 1 if the indicator is disclosed
E,S,G = 0 if the indicator is not disclosed
i = Company
j = Indicator number
t = Observation year

The significance of the hypothesized relationships was assessed using the bootstrapping procedure in SmartPLS. A total of 10,000 bootstrap subsamples were generated using a two-tailed test at the 5% significance level with 95% confidence intervals. Path coefficients, standard errors, t-statistics, p-values, and confidence intervals were examined to assess the significance of the direct and indirect effects. An effect was considered statistically significant when the p-value was below 0.05 and the corresponding 95% confidence interval did not include zero. The indirect effects were assessed using the same procedure to determine whether profitability significantly mediates the relationships between the three ESG dimensions and firm value. Given the repeated firm-year observations, the results are interpreted at the firm-year level rather than as relationships based on 72 independent firms.

Profitability was operationalized using Return on Assets (ROA) and Return on Equity (ROE), while Firm Value was measured using Price-to-Book Value (PBV) and Tobin's Q. ROA was calculated as Net Income divided by Average Total Assets, multiplied by 100%. ROE was calculated as Net Income divided by Average Shareholders' Equity, multiplied by 100%. Average Total Assets and Average Shareholders' Equity were calculated using the beginning and ending values of the respective fiscal year. PBV was calculated as Market Price per Share divided by Book Value per Share, with Book Value per Share calculated as Total Shareholders' Equity divided by the Number of Outstanding Shares. Tobin's Q was calculated as the sum of Market Value of Equity and Total Liabilities divided by Total Assets, where Market Value of Equity was calculated as Market Price per Share multiplied by the Number of Outstanding Shares. Unlike ROA and ROE, PBV and Tobin's Q were retained as ratios and were not multiplied by 100%.

Data analysis was conducted using Structural Equation Modeling Partial Least Squares (SEM-PLS) with SmartPLS software to examine the direct and indirect effects between variables (Saptaria, Setyawan, Erwanto, Buniarto, & Limantara, 2026). ESG Performance, profitability, and firm value were specified as formative/composite constructs, for which PLS-SEM is suitable. The analysis therefore focuses on estimating the relationships among these composite constructs at the firm-year level, while accounting for the repeated observations within the same companies in the interpretation of the results. Details regarding the operational definitions, indicators, and measurement of each variable are presented in Table 1

Table 1. Measurement of variables

No	Variables	Code	Indicator	Measurement
1	Environmental Performance (Ayu. Ms, Pujiati, & Dewi, 2026).	E1	Materials	Disclosure on material use and efficiency
		E2	Energy	Disclosure on energy consumption and efficiency
		E3	Water and Effluents	Disclosure on water use and management
		E4	Biodiversity	Disclosure on biodiversity impact management
		E5	Emissions	Disclosure on emissions and reduction efforts
		E6	Waste	Disclosure on waste management and reduction
		E7	Environmental Compliance	Disclosure on environmental regulatory compliance
		E8	Supplier Environmental Assessment	Disclosure on environmental assessment of suppliers
		E9	Climate Change	Disclosure on climate change risks and opportunities

No	Variables	Code	Indicator	Measurement
1	Environmental Performance (Ayu. Ms, Pujiati, & Dewi, 2026).	E10	Environmental Management and Targets	Disclosure on environmental policies, targets, and programs
2	Social Performance (Ayu. Ms et al., 2026).	S1	Employment	Disclosure of employment practices and relations
		S2	Occupational Health and Safety	Disclosure of occupational health and safety
		S3	Training and Education	Disclosure of employee training and development
		S4	Diversity and Equal Opportunity	Disclosure of diversity and equal opportunity
		S5	Non-discrimination	Disclosure of anti-discrimination practices
		S6	Human Rights Assessment	Disclosure of human rights assessment and protection
		S7	Local Communities	Disclosure of community engagement and empowerment
		S8	Customer Health and Safety	Disclosure of consumer health and safety
		S9	Marketing and Product Information	Disclosure of product information and responsible marketing
		S10	Customer Privacy	Disclosure of consumer privacy protection
3	Governance Performance (Ayu. Ms et al., 2026).	G1	Governance Structure and Composition	Disclosure of governance structure and composition
		G2	Nomination and Selection	Disclosure of the nomination and selection process for governance bodies
		G3	Chair of Governance Body	Disclosure of the role of the head of the governance body
		G4	Role in Impact Management	Disclosure of the governance role in impact management
		G5	Delegation of Responsibility	Disclosure of the delegation of responsibility
		G6	Conflicts of Interest	Disclosure of the management of conflicts of interest
		G7	Critical Concerns	Disclosure of mechanisms for communicating critical concerns
		G8	Collective Knowledge	Disclosure of the competence of governance bodies
		G9	Evaluation	Disclosure of the performance evaluation of governance bodies
		G10	Remuneration	Disclosure of remuneration policies
4	Profitability (Candy, Wong, & Krisyadi, 2026)	P1	Return on Assets (ROA)	ROA = x 100%

No	Variables	Code	Indicator	Measurement
4	Profitability (Candy, Wong, & Krisyadi, 2026)	P2	Return on Equity (ROE)	ROE = x 100%
5	Firm Value (Joshua & Chalid, 2025; Nadifah et al., 2025)	FV1	Price to Book Value (PBV)	PBV = x 100%
		FV2	Tobin Q	Tobin Q =

4. Results and Discussions

4.1 Evaluating the Measurement Model

The results of the measurement model evaluation for Environmental Performance, Social Performance, Governance Performance, Profitability, and Firm Value are presented in Table 2.

Table 2. Reliability and validity

Constructs	Code	Outer loading	Cronbach alpha	CR	AVE
Environmental Performance	E1	0.796			
	E4	0.854			
	E5	0.830			
	E6	0.864			
	E7	0.911			
	E8	0.892			
	E9	0.871			
	E10	0.814			
Social Performance	S1	0.723			
	S2	0.788			
	S3	0.776			
	S4	0.862			
	S5	0.776			
	S6	0.819			
	S7	0.720			
	S8	0.814			
	S9	0.788			
	S10	0.812			
Governance Performance	G1	0.717			
	G2	0.790			
	G3	0.820			
	G4	0.811			
	G5	0.818			
	G6	0.863			
	G7	0.833			
	G8	0.770			
	G9	0.727			
	G10	0.871			
Profitability	P1	0.914	0.799	0.799	0.832
	P2	0.911	0.799	0.799	0.832
Firm Value	FV1	0.942	0.864	0.866	0.880
	FV2	0.935	0.864	0.866	0.880

Table 2 shows that all indicators have outer loading values ranging from 0.717 to 0.942, indicating that they meet the minimum threshold of 0.70 and contribute adequately to reflecting their respective constructs. Cronbach alpha and Composite Reliability (CR) values for all constructs exceed the recommended threshold of 0.70, demonstrating good internal consistency. AVE values are also above

0.50, indicating that each construct explains more than 50% of the variance in its indicators. Overall, these results demonstrate that the constructs of Environmental Performance, Social Performance, Governance Performance, Profitability, and Firm Value meet the criteria for reliability and convergent validity, making them suitable for subsequent structural model analysis.

Table 3. Discriminant validity HTMT

	Firm Value	Profitability
Firm Value		
Profitability	0.852	

The Heterotrait–Monotrait Ratio (HTMT) results in Table 3 indicate that the HTMT value between Firm Value and Profitability is 0.852. This value remains below the common threshold of 0.90; thus, it can be concluded that both constructs possess adequate discriminant validity. Consequently, Firm Value and Profitability are empirically distinguishable constructs that do not exhibit excessive construct overlap.

Table 4. Discriminant validity fornell–larcker criterion

	Firm Value	Profitability
Firm Value	0.838	
Profitability	0.791	0.812

The Fornell–Larcker Criterion results in Table 4 indicate that the square roots of AVE for Firm Value (0.838) and Profitability (0.812) exceed the interconstruct correlation (0.791). These findings demonstrate that both constructs are empirically distinguishable, confirming that discriminant validity has been established based on the Fornell–Larcker criterion.

4.2 Evaluation The Structural Model

Having established the reliability and validity of the measurement model, the next step was to evaluate the structural model. Structural model evaluation began with an assessment of multicollinearity among the predictor constructs using the inner Variance Inflation Factor (Inner VIF). Following the recommendation, Inner VIF values below 5.00 indicate the absence of problematic multicollinearity, thereby confirming that the predictor constructs do not exhibit excessive collinearity.

Table 5. VIF value

Variables	VIF
Environmental Performance → Firm Value	1.836
Environmental Performance → Profitability	2.829
Governance Performance → Firm Value	2.503
Governance Performance → Profitability	2.567
Profitability → Firm Value	1.908
Social Performance → Profitability	2.904

The Variance Inflation Factor (VIF) results in Table 5show that all VIF values fall within the range of 1.836–2.904, well below the common threshold of 5.00. This indicates the absence of significant multicollinearity among the predictor variables in the structural model. Consequently, all exogenous variables can be used simultaneously to test structural relationships without any indication of excessive information redundancy. The structural model illustrating the relationships among the research variables is presented in Figure 1.

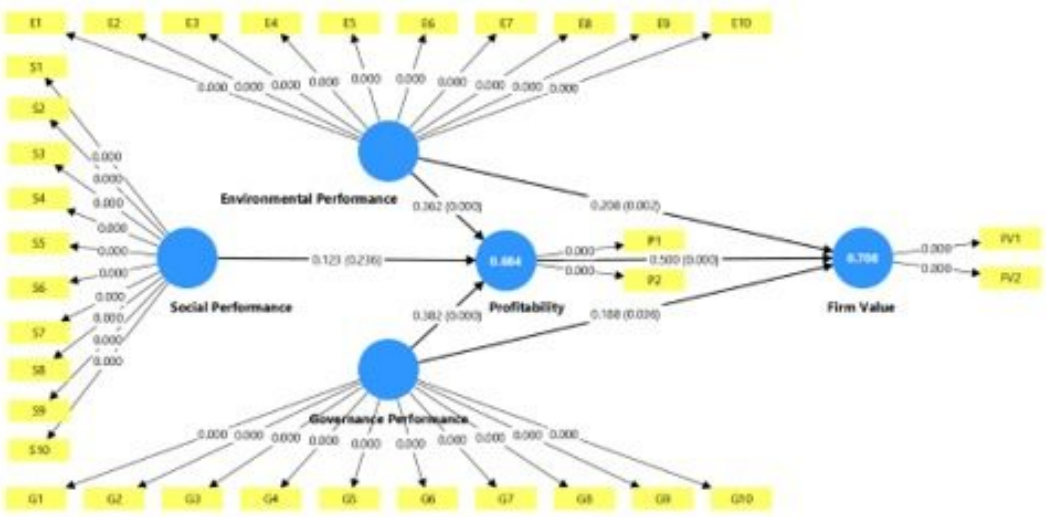


Figure 1. Output of the research model

Table 6. Results of the path coefficients test for direct and indirect effects

Hypotheses	Relationship	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T statistics (|O/STDEV|)	P values	Conclusion
H_1	Environmental Performance → Profitability	0.498	0.364	0.159	2.814	0.024	Accepted
H_2	Social Performance → Profitability	-0.029	-0.002	0.053	0.545	0.586	Rejected
H_3	Governance Performance→ Profitability	0.840	0.823	0.049	17.289	0.000	Accepted
H_4	Environmental Performance → Firm Value	0.339	0.340	0.144	2.711	0.017	Accepted
H_5	Social Performance → Firm Value	-0.010	-0.003	0.018	0.532	0.594	Rejected
H_6	Governance Performance → Firm Value	0.504	0.525	0.135	3.739	0.000	Accepted
H_7	Profitability → Firm Value	0.337	0.312	0.126	2.676	0.007	Accepted
H_8	Environmental Performance → Profitability → Firm Value	0.322	0.323	0.126	2.855	0.012	Accepted
H_9	Social Performance → Profitability → Firm Value	-0.029	-0.002	0.053	0.545	0.586	Rejected
H_{10}	Governance Performance → Profitability → Firm Value	0.283	0.255	0.100	2.834	0.005	Accepted

Based on the path coefficient test results in Table 6, seven hypotheses were accepted and three were rejected. Environmental Performance has a positive and significant effect on Profitability (β = 0.498; t = 2.814; p = 0.024) and Firm Value (β = 0.339; t = 2.711; p = 0.017). Governance Performance also has a positive and significant effect on Profitability (β = 0.840; t = 17.289; p < 0.001) and Firm Value (β = 0.504; t = 3.739; p < 0.001). Furthermore, Profitability has a positive and significant effect on Firm Value (β = 0.337; t = 2.676; p = 0.007). Conversely, Social Performance does not have a

significant effect on either Profitability (β = −0.029; p = 0.586) or Firm Value (β = −0.010; p = 0.594). Regarding indirect effects, Environmental Performance has a positive and significant effect on Firm Value through Profitability (β = 0.322; t = 2.855; p = 0.012), whereas Social Performance does not show a significant indirect effect (β = −0.029; p = 0.586). Governance Performance has a positive and significant effect on Firm Value through Profitability (β = 0.283; t = 2.834; p = 0.005). Thus, H_1, H_3, H_4, H_6, H_7, H_8, and H_{10} are accepted, while H_2, H_5, and H_9 are rejected.

Table 7. Results of the f2 calculation

Relationship	f-square	Description
Environmental Performance → Firm Value	.217	Large effect
Environmental Performance → Profitability	2.166	Large effect
Governance Performance → Firm Value	0.186	Medium effect
Governance Performance → Profitability	1.075	Large effect
Profitability → Firm Value	1.196	Large effect
Social Performance → Profitability	0.006	Negligible effect

The effect size (f^2) results in Table 7 indicate that, overall, Environmental Performance, Governance Performance, and Profitability make a substantive contribution to the endogenous construct, whereas the contribution of Social Performance is relatively minimal.

Table 8. Results of the Q2 Calculation

	Q^2predict	PLS-SEM_RMSE	PLS-SEM_MAE	LM_RMSE	LM_MAE	IA_RMSE	IA_MAE
P1	0.616	0.369	0.232	0.384	0.235	0.595	0.455
P2	0.580	0.407	0.255	0.429	0.267	0.627	0.445
FV1	0.598	0.373	0.243	0.385	0.254	0.589	0.470
FV2	0.537	0.418	0.258	0.444	0.288	0.615	0.483

Note: P = Profitability, FV = Firm Value

The PLSpredict test results in Table 8 show that all indicators have positive Q^2predict values: 0.616 for P1, 0.580 for P2, 0.598 for FV1, and 0.537 for FV2. These findings indicate that the model possesses predictive relevance for the Profitability and Firm Value constructs. Furthermore, the RMSE and MAE values produced by PLS-SEM are lower than the Linear Model (LM) benchmarks across all indicators. PLS-SEM yielded RMSE values of 0.369, 0.407, 0.373, and 0.418, compared to LM RMSE values of 0.384, 0.429, 0.385, and 0.444. A similar pattern is observed for the MAE values. Thus, the PLS-SEM model demonstrates superior out-of-sample predictive capability compared to the LM benchmark for all analyzed indicators.

4.3 Discussion

The research results indicate that Environmental Performance and Governance Performance positively influence both profitability and firm value, whereas Social Performance does not have a significant effect on either variable. Furthermore, profitability is shown to positively influence firm value and mediate the relationship between Environmental Performance and Governance Performance and firm value. Environmental and Governance Performance can enhance profitability by improving operational efficiency, resource utilization, risk control, transparency, and accountability. From a Signaling Theory perspective, strong governance signals better management quality and lower governance-related risk, reducing investor uncertainty. This is particularly relevant for firms in the IDX ESG Leaders Index, which undergo ESG and controversy screening by Sustainalytics (Duan et al., 2023).

The positive effects of Environmental and Governance Performance on Firm Value indicate that investors consider how companies manage environmental and governance risks beyond current profitability. For IDX ESG Leaders firms, ESG status serves as a baseline, while differences in Environmental and Governance performance provide additional signals of risk management, transparency, and oversight. These findings support Stakeholder and Signaling Theories and are consistent with prior evidence that Environmental and Governance dimensions contribute more strongly to financial performance and firm value than the Social dimension (Aydoğmuş et al., 2022).

A further key finding that Social Performance has no effect on either Profitability or Firm Value suggests that within the IDX ESG Leaders group, social activities have not yet generated sufficient economic value or a strong enough signal for the market to translate them into increased profitability and firm value. This finding can be explained through Stakeholder Theory the benefits of social activities tend to be long-term and are not always immediately converted into financial gains. While initiatives such as community development, employee welfare, training, labor rights protection, and consumer protection can enhance a company's relationships with stakeholders, the associated economic benefits may take time to be reflected in metrics like ROA and ROE (Imamah, Arifin, Darmawan, Trinugroho, & Krissanti, 2026). From the perspective of Signaling Theory, information regarding social performance can indeed serve as a positive signal of corporate responsibility. However, investors do not necessarily perceive social signals as direct indicators of profitability. This result differs from previous studies finding that environmental, social, and governance performance individually exert a positive influence on profitability (Zheng et al., 2022). Such discrepancies suggest that the impact of social performance likely depends on market context, industry characteristics, the observation period, and how investors assign economic value to social activities. Several studies also indicate that the relationship between ESG and corporate profitability is not always uniform, as a company's specific context can determine the magnitude of the economic benefits derived from ESG (Tamasiga, Onyeaka, Bakwena, & Ouassou, 2024).

The research results indicate that Environmental Performance has a positive and significant effect on Firm Value, implying that the market assigns a positive valuation to companies with superior environmental performance. Governance Performance also has a positive and significant effect on Firm Value, demonstrating that corporate governance holds value relevance for investors. These findings are significant as they demonstrate that not all ESG activities possess equal value relevance, and the impact of each ESG pillar can vary across industries, countries, and company characteristics (Jain & Bagga, 2025; Rao, Dagar, Sohag, Dagher, & Tanin, 2023).

Profitability was found to have a positive and significant effect on Firm Value. Compared to other direct relationships, the impact of profitability on firm value is among the strongest in the research model. According to Signaling Theory, profitability serves as a direct signal regarding a company's economic quality. High ROA and ROE inform investors that the company is capable of effectively managing assets and capital to generate profit. Strong profitability also boosts investor expectations regarding the company's future ability to generate cash flows and returns (Kurniawan, Siregar, Irawan, & Novianti, 2026; Yu, Guo, & Luu, 2018). From a Stakeholder Theory perspective, profitability indicates that the company can translate its management of stakeholder relationships into economic benefits (Viana, Sari, Buniarto, & Saptaria, 2025). Companies that maintain positive stakeholder relationships can potentially secure support, loyalty, access to resources, and operational stability, all of which ultimately bolster financial performance.

The test results indicate that Profitability significantly mediates the effect of Environmental Performance on Firm Value. These findings suggest that Environmental Performance enhances Firm Value not only through a direct effect but also by boosting Profitability. Viewed through the lens of Stakeholder Theory, profitability represents economic information that investors can more easily translate into increased firm value. In the context of Signaling Theory, this process can be described as a two-stage signaling mechanism. First, environmental performance signals a company's ability to manage risks and sustainability. Second, increased profitability serves as a more concrete financial indicator of management's success in translating sustainability practices into economic benefits

(Purwantini, Hasirun, Handayani, & Sari, 2026). Consequently, investors look not only for strong environmental performance but also for evidence that such practices yield positive financial outcomes (Harnovinsah, Sopanah, Hadijah, Iswari, & Mala, 2023). These findings align with research indicating that financial performance plays a mediating role in the relationship between ESG and firm value (Putra & Budastra, 2024).

The research results indicate that profitability does not mediate the effect of social performance on firm value. The lack of significance in this pathway is consistent with the findings for H2 and H5, which show that social performance has no significant impact on either profitability or firm value. Within the IDX ESG Leaders group selected based on ESG quality social information may be subject to signal dilution, a phenomenon where such information no longer sufficiently distinguishes one company from another. Investors may prioritize indicators more directly linked to risk, efficiency, governance, and the capacity to generate returns. These findings suggest that, within the context of IDX ESG Leaders, corporate social activities have not yet strongly translated into the financial benefits that would subsequently enhance firm value. The results indicate that profitability significantly mediates the effect of governance performance on firm value. This finding suggests that governance performance enhances firm value not only directly but also through increased profitability. This aligns with research demonstrating a positive relationship between governance performance, profitability, and firm value.

5. Conclusions

5.1 Conclusion

This study examines the impact of ESG performance on firm value, with profitability serving as a mediating variable, using a sample of 18 companies consistently listed in the IDX ESG Leaders Index during the 2021–2024 period. The results indicate that the impact of ESG is not uniform across its three dimensions. Environmental and governance performance have a positive and significant influence on both profitability and firm value, suggesting that robust environmental management and corporate governance can generate financial benefits alongside positive market valuations. Conversely, social performance does not significantly affect profitability or firm value, implying that social initiatives have not yet translated into measurable financial or market benefits within the context of the IDX ESG Leaders Index. The study also finds that profitability has a positive and significant impact on firm value and significantly mediates the effects of environmental and governance performance on firm value, but not the relationship between social performance and firm value. These findings indicate that profitability serves as a vital mechanism through which environmental and governance practices are converted into market value.

These findings contribute theoretically by integrating Stakeholder Theory and Signaling Theory to explain the relationship between ESG and firm value. From a practical perspective, the findings suggest that managers should prioritize measurable environmental initiatives, resource efficiency, risk management, transparency, accountability, and effective governance mechanisms to strengthen profitability and firm value. Investors can consider Environmental and Governance Performance as relevant non-financial information when assessing corporate risk, profitability, and long-term value creation, while interpreting Social Performance within a longer-term sustainability perspective rather than assuming immediate financial effects. Regulators can support these efforts by strengthening standardized, transparent, and outcome-oriented ESG disclosure and governance requirements, including more measurable indicators for social performance. Overall, the findings demonstrate that inclusion in the IDX ESG Leaders Index does not eliminate differences in the value relevance of individual ESG dimensions: Environmental and Governance Performance remain significant drivers of economic and market value, whereas Social Performance appears to function more as a foundational sustainability attribute than as a primary differentiator of firm value.

5.2 Research Limitations

This study focuses exclusively on companies consistently included in the IDX ESG Leaders Index during the 2021–2024 period. Companies within this index already exhibit relatively strong ESG performance; this may reduce ESG score variance and limit the generalizability of findings to

companies outside the IDX ESG Leaders Index. Profitability serves as the primary mediating variable, measured via Return on Assets (ROA) and Return on Equity (ROE). While these metrics effectively reflect financial performance, they do not capture other potential mechanisms through which ESG might influence firm value such as corporate reputation, information asymmetry, cost of capital, risk reduction, investor perception, or operational efficiency. The absence of these variables may limit the model's ability to explain the comprehensive mechanisms underlying the relationship between ESG and firm value.

This research relies primarily on secondary data from annual and sustainability reports. ESG information disclosed by companies can vary in terms of scope, depth, and reporting quality. Consequently, measured ESG performance may be influenced by differences in corporate disclosure practices rather than solely by actual differences in sustainability performance. This limitation is particularly relevant when interpreting the lack of significant influence from Social Performance, as the absence of a significant relationship might partly reflect disparities in the quality or comparability of disclosed information. The study employs the PLS-SEM method to examine direct relationships and mediating effects among ESG performance, profitability, and firm value. Although this approach is suitable for analyzing complex relationships and mediating effects, the cross-sectional data structure (firm-year basis) and the observational nature of the data limit the ability to draw robust causal conclusions. Therefore, future research could employ longer panel data periods, alternative econometric approaches, industry-specific analyses, and additional mediating or moderating variables to provide a more comprehensive understanding of how ESG performance translates into profitability and firm value.

5.3 Suggestions and Directions for Future Research

Future research should build upon current findings by expanding sample sizes, observation periods, and industry coverage to include companies beyond those consistently listed in the IDX ESG Leaders Index. Comparative studies between ESG Leaders and non-ESG Leaders are highly recommended to determine whether ESG creates corporate value across varying levels of sustainability performance. Further research could also consider alternative mediation and moderation mechanisms, such as corporate reputation, risk reduction, information asymmetry, cost of capital, and investor perception. Additionally, the use of alternative ESG ratings, panel data methods, and multi-group analysis could provide more robust evidence regarding the mechanisms by which ESG performance translates into profitability and corporate value.

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Author Contributions

DN contributed substantially to the conceptualization of the study, research design, data collection, preparation of the initial draft, project administration, and acquisition of funding. LS contributed to data analysis and software application, literature review and manuscript editing, critical revision of the manuscript, supervision, and final approval of the version to be published. All authors have read and approved the final manuscript and agree to be accountable for all aspects of the work.

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